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SUBJECT: Global Witness Recommends Greater Transparency in Sudan's Oil Industry, Attention to Post 2011 Arrangements

¶1. (U) SUMMARY: UK watchdog organization, Global Witness (GW), at an open meeting September 10 in Juba, reported that there are serious discrepancies in the reporting of Sudan's oil production and revenues, nearly all of which result in an underreporting of Southern Sudan's share of this national resource. This underpayment to the South could total hundreds of millions of dollars. Sensitive to the incendiary nature of its conclusions, GW emphasized its analysis was based on incomplete information. It stressed that transparency, including greater data disclosure and historical audits, would be the best way to lift the cloud of suspicion that hangs over oil's role in North-South fiscal relations. GW raised concerns that the Wealth Sharing Agreement (WSA) contained in the Comprehensive Peace Agreement (CPA) only runs until 2011, at which point the provisions governing Sudan's oil industry since 2005 will lapse. GW recommends that negotiations regarding wealth sharing and contractual arrangements in the oil industry begin immediately to avoid future insecurity. With the opportunity to re-open the WSA, and a reasonable negotiating period, the GW report makes ten "key recommendations" for increased transparency in Sudan's oil sector as a pathway to building trust among relevant stakeholders. END SUMMARY.

GoSS, AEC Reject Aspects of Report

¶2. (U) Mr. John Luk Jok, the Government of Southern Sudan (GoSS) Minister of Energy and Mining (MOEM), who attended the meeting, rejected several aspects of the report. He disputed the GW insinuation that GoSS failed in its responsibility to monitor Sudan's oil production, pointing out that there were currently 18 MOEM employees monitoring oil production and transportation facilities. Minister Jok outlined the improvements made in availability and disclosure of production, export, and revenue data, and stated that GoSS and its Norwegian technical experts were satisfied that revenues were being shared equally as specified in the WSA. Minister Jok's comments were echoed by the Assessment and Evaluation Commission (AEC) Co-ordinator, Simon Giverin, who took issue with several aspects of the report, particularly the timing of its release.

VERIFYING OIL PRODUCTION AND EXPORT

¶3. (U) According to the GW report, the key inputs necessary for determining Sudan's total oil revenues, and Southern Sudan's share of these revenues, are the amount of oil produced and exported, the price at which the oil is sold, and the various deductions taken before determination of Southern Sudan's 50 percent share is made. GW acknowledges that Government of Sudan (GoS) agencies make oil production, export, and revenue data available; however, they point out that there are deficiencies and inconsistencies in the data.

(Note: Assembling data is difficult for all but the determined financial analyst, and there is little, if any, way that data can be verified. End Note.) For example, the report states that oil production data for 2005 and 2006 are found on the Central Bank of Sudan (CBoS) website, while more recent data are located on the Ministry of Finance (MoF) website. GW also points out that the Joint Technical Committee for Oil Revenue and Distribution, a committee staffed by civil servants from Khartoum and Juba established pursuant to the CPA, meets monthly to review and approve oil export and production figures, but has no way independently to verify GoS MOEM supplied data. In addition, published figures seriously lag actual production/sales; most of the 2007 data, and all of the 2008 data, were not published until April 2009, according to the report.

¶4. (U) GW analyzed production data from the principal producing fields in Southern Sudan. Government figures were taken from MoF data (originally prepared for the IMF) that are to be found on the Ministry's website. These data were compared against the production data published by the China National Petroleum Corporation (CNPC), the operator of three of three of the four productive blocks in Sudan. Although the comparisons were not perfect and the numbers needed massaging, the results showed a consistent undercounting in the Sudanese production data versus that of CNPC. For example (using 2007 data), CNPC reported the daily production rate of the Greater Nile Petroleum Operating Company (GNPOC) [Blocks 1,2, and 4] at 270,000 barrels per day (bpd), while the MoF reported a production rate 9 percent less, at 245,614 bpd. Petrodar data [Blocks 3 and 7] shows 2007 production of 74.5 million barrels versus the MOF reported production of 64.0 million barrels, an amount 14 percent less. A comparison of 2005 data for GNPOC and Petro Energy [blocks 1,2,4 and 6] shows a 26 percent difference between CNPC and

Government-reported production. By way of comparison, GW reports that CNPC and Government of Sudan 2007 production data for Petro Energy [block 6], where there is no sharing of revenues between the North and South, are almost exactly the same, approximately 40,000 bpd.

¶5. (U) The GW report uses such comparisons to make a case that there is a serious undercounting of oil production from fields where the GoS shares oil revenues with Southern Sudan. In the report, and in its presentation in Juba, GW softened its tone to say that production discrepancies were sufficiently large to justify an independent audit, and full disclosure of the results, to resolve the issue once and for all. (Note: This approach addresses the need to resolve discrepancies, the largest of which, 26 percent, comes from 2005 data, and the others, 14 percent and 9 percent, use more current, 2007, data. It also takes into account that those close to the situation, including GoSS members of the Joint Technical Committee for Oil Revenue and Distribution and the Norwegian Oil Envoy, agree that oil production disclosure has improved over time and current reporting is acceptable. End Note.)

VERIFYING THE PRICE OF OIL SALES

¶6. (U) The report notes that most Southern Sudanese express their concerns in terms of an undercounting of oil production. However, the GoSS does not receive the oil itself, but rather a percentage of oil revenues. The MOEM in Khartoum has the exclusive right to market Sudan's oil, and oil industry experts agree, especially given the unique characteristics of most Sudanese crude oil, that it would be far easier to manipulate oil export prices than production. In the report, GW made the case for developing a joint North-South oil marketing organization, improved contract tendering processes, and verification of sales prices by an independent auditor, whose audits would be made public.

¶7. (U) The report explains that Sudan produces three sorts of crude oil: Nile, Dar, and Fula Blends. There is no quoted price for Fula Blend, which is produced entirely in the North and used as feedstock for domestic refineries. Dar and Nile Blends are exported, and the

MoF and CBOS publish sales price data on their websites. However, the delay in releasing price data is comparable to that of production data, the report states. Nile Blend is reasonably high quality crude sold at prices close to world benchmarks. Due to the difficulties of transporting and processing Dar Blend, though, it trades at substantial discounts to benchmark crudes, GW points out.

¶8. (U) GW analyzed the 2007/2008 sales price data disclosed on the MoF website against the data for Sudanese Government oil sales published in RIM Crude Intelligence Daily (Note: A respected trade publication. End Note.) Of the 23 price comparisons available for Nile Blend, 20 had a higher price reported in the industry press and three had a higher price in the MoF figures, the report states. Measured on an overall basis, RIM Crude Intelligence Daily reported prices were $1.14/barrel higher than those reported by the GoS MOEM, which represents a revenue loss of $65 million on 57 million barrels of crude sold during this period, according to the report. As a knowledgeable observer would expect, the pricing of Dar Blend was much less continuous, the discrepancies were larger (as a percent of sales price), and there was not a clear pattern of over/under pricing, the report stated. Significantly, there were some outliers in the pricing of Dar Blend. In particular, there were four sales of Dar Blend in February 2007 that ranged between 15 and 23 cents per barrel when earlier sales had been at USD 14.38. A Sudanese delegation traveled to China soon after that and negotiated increased prices, the report states.

9.(U) GW made a series of recommendations to improve the marketing of Sudanese oil including establishing an independent sales organization with a Supervisory Board composed of GoS and GoSS representatives. In addition, they recommended that the practice of "closed tenders" at which only Chinese companies can bid be eliminated, and all oil sales be made by open tender. Finally, GW argued that publication of sales data should be timelier and more widely disseminated than on the MoF website. As with oil production levels, GW argues that an independent audit of sales volumes and prices would be an important way to build credibility in both the North and South.

VERIFYING THE COSTS AND FEES

¶10. (U) The cost of operating Sudan's oil fields, which can run as much as 45 percent of total revenues, are deducted before the North and South split profits, the GW report points out. Most of these costs are controlled by the GoS MOEM or the field operator (usually CNPC), allowing ample opportunity for manipulating the profitability of operations. Sudanese oil is extracted under "Production Sharing" agreements, which provide for crude oil production to be divided between the operating companies and the Government, the report explains. Companies recover their operating and development costs from "cost oil," up to a maximum percentage termed the "cost stop." Oil companies do not automatically receive this maximum, but they can claim back-documented expenses up to this amount. The remaining oil is termed "profit oil," and the contract specifies the basis on which this oil is split between the oil company and the Government. GoS profit oil is subject to the CPA Wealth Sharing Agreement. "Excess Oil" is a component of profit oil that relates to the difference between the cost stop and the actual costs that have been claimed. (Comment: Given the relatively high cost of oil production in Sudan, it is surprising how little attention is paid to operating costs and fees, or their effect on Southern Sudan's oil revenues. End Comment.) The GoS MOEM does not disclose any cost figures, nor are these data available for the Joint Technical Committee for Oil Revenue Distribution. It is not possible for the Southern Sudan Government or its people to independently verify such costs, the GW report points out.

¶11. (U) GW identifies a number of elements in the cost structure of Sudanese oil production that merit improved disclosure. For example, details of the contracts between the GoS MOEM and the oil companies need to be disclosed, including division of the profit

oil. At present, many in the South suspect that revenues from excess oil are retained by Khartoum, instead of being divided according to WSA provisions. The GoS MOEM deducts a three percent management fee, which is not provided for in the CPA, from oil revenues that accrue to Southern Sudan. (Comment: This fee appears unjustified, especially when the GoS retains half the profit from Southern production. Pipeline fees, although not included in the WSA, are more justifiable. End Comment.) However, there is no identifiable basis for calculating pipeline fees, which vary from USD 4.05 to USD 8.60 per barrel (3 percent to 8 percent of revenue), nor is it clear which party/parties ultimately receive these fees. The report notes that management and pipeline fees add up. In August 2008, the management fee exceeded $25 million and pipeline fees totaled $40 million. The report points out that the GoS also deducts the cost of services it provides Southern Sudan, such as road building, from the amounts the South is due. Finally, through its ownership of Sudapet (the state-owned oil company), the GoS has an equity stake in all the oil consortia operating in the country. The GoS keeps 100 percent of Sudapet profits, without sharing this income with the GoSS because Sudapet profits were not included in the WSA.

ENSURING OVERSIGHT OF OIL REVENUES

12.(U) GW repeatedly makes the case that current levels of disclosure are inadequate. This is particularly true for oil development contracts, pipeline contracts, and operating and development expenses, for which there is little, if any, disclosure. However, the need for disclosure also applies to data such as production, export, and selling price data, which are disclosed, but too far in arrears and on difficult-to- access websites. GW applauds the increasing activity of the North/South Joint Technical Committee for Oil Revenue Distribution, as well as the decision to provide representatives of the Norwegian Oil Development program with access to previously confidential contracts and related documents. However, GW recommends that others, both domestic and international, must become involved, if mutual trust between the North and South is to be established. GW argues that the Southern Sudan Audit Chamber needs to be expanded and strengthened to take over expanded responsibilities for the audit of oil industry data. In addition, GW advocates that the Southern Sudan Legislative Assembly become more active in mandating the disclosure of oil industry data by law, noting that many confidentiality agreements contain clauses that prohibit the disclosure of information "except as provided by law." Internationally, GW advocates greater involvement of a number of parties, including China (producer), Japan (refiner), Norway (technical assistance provider), United States (significant influence on the North and South), the International Guarantors named in Sudan's CPA, the IMF (published guide on resource transparency), and the Extractive Industries Transparency Initiative.

END OF THE WEALTH SHARING AGREEMENT

¶13. (U) GW warns that the CPA contains a wealth of information as to the conduct of the North-South relationship during the interim period, but it supplies nothing governing the future of this relationship after the 2011 end date. Whether the outcome of the referendum vote is unity or separation, the parties need to agree what will happen to the oil, oil contracts, oil revenues, and the Oil Revenue Stabilization Account in the post-CPA period, the report states. Hammering out an effective and enduring agreement will be a challenge against the backdrop of the referendum; however, such agreement must be found. There is an uneasy mutual dependency between the two: the North needs the revenue it earns from oil produced in Southern Sudan, and in turn, Southern Sudan cannot get its oil to market without access to the North's pipeline and the Port Sudan terminal. While, ultimately, Southern Sudan may be able to break the North's monopoly on the transportation and delivery of oil, the construction of such alternate pipelines is still in the planning stage. In the meantime, the GW report urges the

international community to facilitate the GoS and GoSS coming to agreement on these issues in advance of the CPA end date.

TEN KEY RECOMMENDATIONS

¶14. (U) GW made ten key recommendations for improving the transparency of Sudan's oil industry. Each is a crucial step necessary, in their view, to build trust between the North and South as they navigate the contentious issues surrounding the upcoming elections and referendum vote. These recommendations are as follows:
-- The oil production, export, and sales figures, upon which revenue sharing depend, should be verified.
-- An agreement should be reached covering wealth sharing and contractual arrangements when the CPA ends in 2011.
-- Costs and fees deducted from oil revenues should be audited, including reimbursements of oil companies' investments, pipeline fees, and the management fees paid to the GoS.
-- Both GoSS and the GoS should oversee marketing arrangements for Sudan's oil.
-- The international community must increase efforts to promote oil industry transparency.
-- The National, Southern, and State Governments should increase their oversight of the oil revenues accruing to them.
-- The state oil companies of Sudan (Sudapet) and Southern Sudan (Nilepet) should be restructured to avoid conflicts of interest.
-- The National Petroleum Commission should be strengthened allowing it to assume its responsibility to set Sudan's energy policies.
-- Employment of Southern Sudanese in the oil industry should be increased.

¶15. (SBU) Comment: The Southern Sudanese have long suspected that the GoS has underreported oil revenues as a way of cheating the South out of its rightful share of the country's oil wealth. The GW report does much to vindicate Southern Sudanese suspicions on this score. Sensitive to the incendiary nature of its conclusions, GW's emphasis on transparency, including greater data disclosure and historical audits, appears to be the best way to lift the cloud of suspicion that hangs over oil's role in North-South fiscal relations.

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